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No. 88-94

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY, AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC.,
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

This *amicus curiae* brief is respectfully submitted pursuant to Rules 21 and 36 of this Court by the Interstate Natural Gas Association of America ("INGAA") in support of the Petition for Writ of Certiorari of Kentucky West Virginia Gas Company and Equitable Gas Company, a Division of Equitable Resources, Inc.[1]

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[1] In accordance with Supreme Court Rule 36, INGAA has obtained the consent of all parties currently participating in this proceeding to file this brief as *amicus curiae*. These letters of consent have been filed with the Clerk of the Court.

INTEREST OF THE AMICUS CURIAE

INGAA is a nonprofit national association whose members include virtually all of the major interstate natural gas transmission companies operating in the United States and three Canadian interprovincial pipelines which are categorized as Group I pipelines by the National Energy Board of Canada.[2] Its U.S. members account for over 90% of all natural gas transported and sold for resale in interstate commerce, and they are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717 *et seq.*; the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* These companies provide interstate wholesale natural gas service[3] in the lower 48 contiguous states with the exception of Vermont. The average number of states served by these pipelines is six, but some companies serve as many as eighteen states.

The decision of the Third Circuit in *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (1988) involves the proper interpretation of the filed rate doctrine as defined by this Court on numerous occasions and most recently in *Mississippi Power & Light Co. v. Mississippi*, 108 S.Ct. 2428 (1988) ("*Mississippi Power*"), and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) ("*Nanta-*

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[2] *See* Appendix, *infra*. The natural gas industry is divided into three basic segments. Broadly speaking, gas producers operate the wells that are the source of natural gas; interstate natural gas pipelines buy and transport gas from the wellhead to points of delivery; and local distribution companies are the utilities that provide service to homes and businesses, as well as large industrial end users.

[3] The term "natural gas company" is defined in the NGA as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 15 U.S.C. § 717a(6) (1982). The term "wholesale" when used in this brief, is synonymous with the phrase "sale . . . for resale" in § 717a(6).

hala"). The Third Circuit misconstrued the doctrine in a manner that threatens to adversely impact the interstate natural gas pipeline industry and is inconsistent with this Court's rulings in *Mississippi Power* and *Nantahala*.

SUMMARY OF ARGUMENT

The Pennsylvania Public Utility Commission ("PUC") denied the right of petitioner Equitable Gas Company ("Equitable") to recover costs incurred by it in purchasing natural gas at wholesale under a federally approved tariff from petitioner Kentucky West Virginia Gas Company ("Kentucky West"). Relying on a new state law, Pennsylvania Act 74, 66 Pa. Cons. Stat. Ann. 1307(f) *et seq.*[4], the state agency disallowed the passthrough of certain purchased gas costs because the purchaser ("Equitable"), notwithstanding its contractual obligation to pay for minimum amounts of gas from the interstate supplier ("Kentucky West"), had not, in the view of the PUC, demonstrated that it had prudently pursued a least-cost fuel procurement policy in accordance with Pennsylvania Act 74. The sale and purchase of the gas in question were covered by tariffs filed with and approved by the FERC. Thus, the question presented is whether the filed rate doctrine established by this Court in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951) and reaffirmed in *Mississippi Power* and *Nantahala*, requires a state public utility commission to allow a utility to recover through its retail rates a fixed, unavoidable cost incurred by the utility pursuant to its contract with a pipeline embodied in a tariff approved by the FERC.

In passing the NGA in 1938, the Congress declared that "the business of transporting and selling natural gas for ultimate distribution to the public is affected with a pub-

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[4] The relevant portions of Pa. Act 74 are printed in the Appendix to the Petition, Appendix H, at 168a-75a.

lic interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest." 15 U.S.C. 717(a). Even before enactment of the NGA, this Court stated categorically that the sale of gas in wholesale quantities across state lines was a matter for national, rather than local, regulation. *See Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298, 309-310 (1924). The Court went on to say, "The paramount interest is not local but national, admitting of and requiring uniformity of regulation." *Id.* Thus it has long been settled that interstate sales of natural gas for resale are not subject to state regulation. Moreover, the Court has repeatedly held that the NGA provides "a comprehensive scheme of federal regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company.'" *Northern Natural Gas Co. v. State Corporation Comm'n*, 372 U.S. 84, 91 (1963) (quoting *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682 (1954)); *see also Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 418-24 (1986); *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145 (1988).

The filed rate doctrine is an essential component of the comprehensive scheme of federal regulation. The Commission's authority to regulate interstate wholesales of natural gas is exclusive. *Cf. Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981). The part of the doctrine that applies here holds that a "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala*, 476 U.S. at 965; *see also Mississippi Power*, 108 S.Ct. at 2440. When the FERC approved the minimum bill provision in Kentucky West's tariff, Equitable became subject to an unavoidable federal obligation and entitled to recover

same through its retail rates. Thus, the Pennsylvania PUC's refusal to allow Equitable to recover such costs violates the filed rate doctrine. Further, it contravenes the comprehensive scheme of Federal regulation mandated by Congress and recognized by this Court, and is inconsistent with this Court's pronouncements that "a state agency's 'efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity.'" *Id.* at 2442 (quoting with approval *Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981)).

Because the Third Circuit's ruling is strikingly similar to the error recently corrected by this Court in *Mississippi Power*, petitioner's request should be granted and a writ of certiorari issued to the Third Circuit's decision.

ARGUMENT

I. THE COURT OF APPEALS' DECISION CREATES CONFUSION ABOUT THE CONTOURS OF THE FILED RATE DOCTRINE AND THREATENS TO ADVERSELY IMPACT THE INTERSTATE NATURAL GAS PIPELINE INDUSTRY.

A. Pipelines Recover A Significant Proportion Of Their Fixed Costs Through Fixed Charges Set By The FERC.

The natural gas pipeline industry is highly capital intensive, with huge investments in pipeline and appurtenant facilities such as compressor stations and metering and pressure regulating equipment. This is reflected in the net utility plant of major interstate natural gas pipelines for 1986 of $9,227,398,000.[5] These plant costs incurred by a pipeline are allocated among a pipeline's customers by the FERC pursuant to FERC's exclusive NGA authority to set the wholesale rates charged by interstate

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[5] EIA Statistics of Interstate Natural Gas Pipeline Companies, 1986, Table 1 at 5.

pipelines. *See* 15 U.S.C. §§ 717c-717d. The Commission uses several methodologies to allocate costs among pipeline customers. For example, the Commission has authorized pipelines to include in their rates a "demand charge"—a fixed sum paid by a customer regardless of the amount of gas the customer actually purchases from the pipeline—that is designed to permit the pipeline to recover a portion of its fixed costs—its investment in facilities. In addition to making large investments in facilities, each pipeline must ensure that it has sufficient supply to fulfill its obligation to deliver to the customer the amount of gas to which that customer is contractually entitled. The supply contracts traditionally entered into by pipelines with producers in order to satisfy this obligation frequently contain "take-or-pay" clauses requiring the pipeline to pay for a minimum amount of gas whether or not it actually takes delivery of that gas. Such payments also are part of a pipeline's cost. *See generally Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1150-51 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).[6]

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[6] Similarly, most pipelines, until recently, were permitted to have minimum bill provisions in their tariffs which imposed upon certain of the pipeline's customers the unavoidable obligation to pay for a specified amount of gas whether or not the customer took delivery of that gas. The purpose of such a provision was to provide pipelines with a source of revenue to cover a portion of their fixed costs and their take-or-pay obligations to gas producers. In its Order No. 380, issued May 30, 1984, *FERC Statutes and Regulations* [*Regulations Preambles 1982-1985*], ¶ 30,571 (1984), *aff'd, Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986), the FERC eliminated variable cost but not the fixed cost recovery portion of the minimum bill. (This action, however, essentially post-dates the period of cost recovery at issue before the PUC, July, 1983-December, 1984). Furthermore, the Pennsylvania PUC's implementation of Act 74, as will be shown *infra*, goes well beyond the elimination of variable cost recovery through minimum bills. It would deny the pipeline's customers the opportunity, indeed the right, to recover *fixed costs*

In the instant case, the costs incurred by Kentucky West in supplying its customers, including Equitable, were allocated among those customers in accordance with Kentucky West's filed tariff and the methodology employed and approved by the FERC. By reason of that action, Equitable was obligated to take delivery of, or pay for if not taken, minimum quantities of natural gas from Kentucky West. The PUC, in denying Equitable its right to recover the costs of its purchases from Kentucky West on the ground that they were not prudently incurred costs and inconsistent with Pennsylvania Act 74, has launched a direct attack on well-established preemptive force of Federal Energy Regulatory Commission approved tariffs and the recovery of those FERC-approved costs when they are passed on to the interstate pipeline's utility customers.[7] This ruling, which was affirmed by the Third Circuit, is inconsistent with the recent decision of this Court in *Mississippi Power*, that the Supremacy Clause bars a state from applying a state-law prudency standard to prevent a utility from recovering costs that the utility was obligated to incur under a FERC-approved tariff.

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of the pipeline as approved by the FERC and included in the pipeline's filed rates. This is at the very core of the federal regulatory scheme and represents a direct and substantive incursion on that scheme.

[7] The filed rate doctrine which the filed tariff represents was established by this Court in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951) and stands for the proposition that the rate filed and approved by the Federal Power Commission, predecessor to the FERC, is the only legitimate rate. The preemptiveness of wholesale rates on file or approved by the FERC was recognized by this Court in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). The relevant provisions of Pa. Act 74 are printed in the Appendix to the Petition, Appendix H at 168a-75a.

B. The Court Of Appeals' Decision Is Clearly At Odds With The Filed Rate Doctrine.

The filed rate doctrine protects the "exclusive authority" of the FERC to "determine the reasonableness of wholesale rates." *Mississippi Power*, 108 S.Ct. at 2439; *Nantahala*, 476 U.S. at 963-64. This Court held in *Mississippi Power* that

> . . . States may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates. "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the cost of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited."

Id. (quoting *Nantahala*, 476 U.S. at 970).

The application of this principle is clearest when a utility incurs a fixed, unavoidable cost pursuant to a FERC-approved tariff, such as a fixed cost imposed upon local distribution companies ("LDCs") by the demand charge or minimum bill provisions of pipelines' tariffs. Since LDCs are legally obligated to incur these FERC-approved costs, state utility commissions must permit their recovery through the LDC's retail rates. *Mississippi Power* at 2440; *Nantahala*, 476 U.S. at 965.

The petition for writ of certiorari shows (at 12-20) that the PUC violated the filed rate doctrine when it barred Equitable from recovering through its retail rates costs incurred pursuant to the minimum bill provision of Kentucky West's FERC-approved tariff. The court of appeals' failure to correct that error itself creates uncer-

tainty about the application of the filed rate doctrine in this context. The Third Circuit concluded (Pet. App. at 21a, 837 F.2d at 610) that a minimum bill provision was not relevant because Equitable sought to recover costs incurred for gas that was delivered rather than costs for gas that was not delivered. But the applicability of the minimum bill provision does not turn upon whether Equitable chose to take delivery of the gas; that provision imposed upon Equitable the fixed unavoidable obligation of paying a specified amount of money to Kentucky West whether it took the gas or not. The obligation of an LDC to pay an allocated share of its pipeline supplier's fixed costs is ongoing and not solely dependent upon the minimum bill.

The Third Circuit's opinion goes on to compound the uncertainty by apparently concluding that state regulators are free to determine whether a FERC-approved tariff need ever be considered in setting retail rates. Under the court's erroneous analysis, the relevance of the FERC tariff under the filed rate doctrine is a question of fact, as to which the state regulatory commission's determination is "preclusive," even though that determination was made in the course of a state-law prudency proceeding. Pet. App. at 21a-22a, 837 F.2d at 611.

The Third Circuit's approach is plainly wrong. Allowing the states to use factual findings of the sort cited by the court of appeals (Pet. App. at 20a-21a, 837 F.2d at 610) to avoid the effect of the filed rate doctrine gives the states a clear opportunity to prevent the passthrough of FERC-approved costs whenever they wish. Such latitude would be a clear infringement by the states on the comprehensive scheme of federal regulation which this Court has so often sought to protect. See *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409 (1986), *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145 (1988).

C. In Order To Eliminate Uncertainty And Avoid Adverse Consequences For The Pipeline Industry, This Court Should Grant The Relief Sought By Petitioners.

As indicated above, the uncertainty generated by the court of appeals' opinion about the extent to which the filed rate doctrine requires state regulators to allow the recovery of fixed costs approved by the FERC could have serious adverse consequences for the natural gas industry in general and for pipelines in particular. If a local distribution company cannot recover expenditures in satisfaction of FERC-approved fixed charges, the financial stability of the industry will clearly be threatened. Pipelines and distributors are entitled to the opportunity to recover their prudently incurred costs. Those investments were undertaken on the basis of FERC certificates of public convenience and necessity and on the basis of approved tariffs. Likewise, distributors are entitled to recover these prudently incurred costs in their retail rates. The Third Circuit's ruling destroys that symmetry and involves the very "trapping" of costs which was condemned by this Court in *Mississippi Power*.

At the retail level, the Third Circuit's decision casts doubt upon an LDC's right to insist that a particular cost be passed through to its retail customers pursuant to the filed rate doctrine. To the extent other courts and state regulatory bodies adopt a similar approach, the resulting confusion could turn the natural gas industry upside down. In view of the considerable fixed costs borne by pipelines (see page 5, *supra*), such a state of affairs could seriously affect the economic viability of interstate natural gas pipelines, and cast doubt on their ability to render whatever service may indeed be requested of them.[8]

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[8] This result would also unsettle the expectations of pipeline investors, who previously could be certain that LDCs would be able to pass these FERC-approved fixed charges through to consumers pursuant to the filed rate doctrine.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted to the U.S. Court of Appeals of the Third Circuit.

Respectfully submitted,

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September 19, 1988

APPENDIX

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

1988 ACTIVE MEMBERSHIP

AlaTenn Resources, Inc.
Arkla, Inc.
The Coastal Corporation
Columbia Gas Transmission Corp.
Consolidated Natural Gas Company
El Paso Natural Gas Company
Enron Corp.
Foothills Pipe Lines (Yukon) Ltd.
Granite State Gas Transmission, Inc.
Great Lakes Gas Transmission Company
Kentucky West Virginia Gas Company
KN Energy, Inc.
Lone Star Gas Company
Michigan Gas Storage Company
MidCon Corp.
Pacific Gas Transmission Company
Pacific Interstate Company
Panhandle Eastern Corporation
Polo Energy Corporation
Questar Pipeline Company
SONAT, Inc.
Tenneco Gas Pipeline Group
Texas Eastern Gas Pipeline Company
Texas Gas Transmission Corporation
Texas Oil & Gas Corporation
TransCanada Pipe Lines
Transcontinental Gas Pipe Line Corporation
United Gas Pipe Line Company
Valero Interstate Transmission Company
Valley Gas Transmission, Inc.
Westcoast Energy Inc.
The Williams Companies
Williston Basin Interstate Pipeline Company
Wintershall Corporation

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

1988 ASSOCIATE MEMBERS

AMAX Oil & Gas Inc.
Amoco Production Company
ARCO Oil and Gas Company
Atlanta Gas Light Company
The Brooklyn Union Gas Company
Chevron USA
Conoco Inc.
Entex, Incorporated
Exxon Company, U.S.A.
John H. Hill
Kerr-McGee Corporation
Kinsey Interests, Inc.
Laclede Gas Company
Lear Petroleum Exploration Company
Marathon Oil Company
Mewbourne Oil Company
Mobil Oil Corporation
National Fuel Gas Company
Northern Indiana Public Service Company
Oklahoma Natural Gas Company,
a Division of ONEOK Inc.
OXY USA Inc.
Pennzoil Company
Phillips Petroleum Company
Shell Oil Company
Southern California Gas Company
Sun Exploration & Production Company
Texaco U.S.A.
Union Pacific Resources Company
Unocal Corporation